

BRIDGING THE GAP

The delay in the national and California economic recoveries is projected to result in a budget shortfall in the current year and budget year combined of \$34.6 billion. This funding gap is calculated by comparing total revenues expected to be received by the State with the cost of providing current services pursuant to existing statute and reflecting changes in caseload, enrollment, and population.

For the second year in a row, the Administration proposed significant mid-year budget actions to help close the budget gap. The \$10.2 billion in savings associated with the 2002 Mid-Year Spending Reduction Proposals is comprised of cuts/savings (\$9.0 billion), State-local realignment (\$192 million), fund shifts (\$816 million), transfers/other revenues (\$200 million), and loans/borrowing (\$25 million).

Among the mid-year reduction proposals advanced by the Administration in December 2002 were the following major items (see the December 2002 Mid-Year Spending Reduction Proposals section for additional detail):

- ◆ **Rescind Expansion of the 1931(b) Medi-Cal Program**—\$236 million (\$118 million General Fund)
- ◆ **Reinstate Medi-Cal Quarterly Status Reporting**—\$170 million (\$85 million General Fund)
- ◆ **Implement Statewide Standards for Regional Center Purchase of Services**—\$100 million in 2003-04
- ◆ **Eliminate Cost-Of-Living Adjustments For SSI/SSP and CalWORKs Grants**—\$36.3 million (\$24.1 million General Fund) in 2002-03 and \$563.4 million (\$408.3 million General Fund) in 2003-04
- ◆ **Across-the-Board Reduction for K-14 Schools**—\$1.078 billion



- ◆ **Base Reduction for Higher Education**—\$455 million
- ◆ **Suspend Supplemental Benefit Maintenance Account Payment to State Teachers' Retirement Fund**—\$500 million
- ◆ **Reduce State Employee Compensation Costs**—\$854 million (\$470 million General Fund)
- ◆ **Suspend Transportation Investment Fund Transfer**—\$1 billion
- ◆ **Transfer Unencumbered Low and Moderate Income Housing Funds**—\$500 million

To close the balance of the \$34.6 billion budget gap, the 2003-04 Governor's Budget proposes additional budget measures totaling \$24.4 billion. Figure A outlines the measures comprising the overall solution to closing the entire \$34.6 billion shortfall.

Figure A
Addressing the Overall \$34.6 billion Gap
(Dollars in millions)

	<u>December Revision</u>	<u>Additional Measures</u>	<u>Total</u>	<u>%</u>
Cuts/Savings	\$8,966.4*	\$11,761.9	\$20,728.3	59.9%
State-Local Realignment	191.6**	7,962.4	8,154.0	23.6%
Fund Shifts	815.6	1,087.1	1,902.7	5.5%
Transfers/Other Revenue	199.7*	1,914.6	2,114.3	6.1%
Loans/Borrowing	<u>25.4</u>	<u>1,657.9</u>	<u>1,683.3</u>	<u>4.9%</u>
Totals	\$10,198.7	\$24,383.9	\$34,582.6	100.0%

* \$500 million property tax from Redevelopment Agencies was classified as "Other Revenue" in the Mid-Year Spending Reduction Proposals plan. It is now used to offset Proposition 98 expenditures (as cuts/savings).

**\$191.6 million of Proposition 98 CalWORKs Stage 3 elimination was classified as "Cuts/Savings" in the Mid-Year Spending Reduction Proposals plan. This amount is currently part of the State-local realignment package.



Cuts/Savings—\$11.8 billion

In addition to reductions proposed in the Mid-Year Spending Reduction Proposals plan submitted to the Legislature in December 2002, the following highlights some of the major reduction proposals in the Governor's Budget:

Department of Health Services—Medi-Cal

- ◆ **County Administration Accountability**—Including funding of \$49.3 million (\$24.6 million General Fund) in 2002-03 and \$33.4 million (\$16.7 million General Fund) in 2003-04 to allow counties to perform regular Medi-Cal eligibility redeterminations, to achieve savings of \$388 million (\$194 million General Fund) in 2003-04. Annual savings beginning in 2004-05 are estimated to reach \$642 million (\$321 million General Fund).
- ◆ **Medi-Cal Aged and Disabled Program**—Rescinding the January 2001 expansion of the aged and disabled Medi-Cal eligibility income limit from 133 percent of the federal poverty level to the Supplemental Security Income/State Supplementary Payment (SSI/SSP) benefit level, to reflect savings of \$127.6 million (\$63.8 million General Fund).
- ◆ **Second Year of Transitional Medi-Cal (TMC)**—Eliminating the State-only program, leaving former CalWORKS recipients with one year of transitional Medi-Cal coverage.
- ◆ **Optional Benefits**—Eliminating an additional ten optional benefits, in addition to the eight optional benefits proposed in December 2002 for elimination, for 2003-04 savings of \$175.6 million (\$87.8 million General Fund). These include the following benefits: (1) hospice, (2) non-emergency medical transportation, (3) optometry, (4) optician/lab services, (5) physical therapy, (6) prosthetics, (7) orthotics, (8) speech/audiology, (9) hearing aids, and (10) durable medical equipment. Pursuant to federal requirements, these benefits will still be provided to children under 21 and beneficiaries of long-term care services.
- ◆ **Provider Rates**—Reducing provider rates by an additional 5 percent over the 10 percent rate reduction proposed in December 2002, to achieve savings of \$479.3 million (\$241.9 million General Fund) in 2003-04. Hospital inpatient and outpatient services, federally qualified health clinics, and rural health clinics will be exempt from the reduction.



- ◆ **Wage Adjustment Rate Program**—Eliminating the supplemental payment to long-term care facilities that have a collectively bargained agreement to increase salaries, wages, or benefits for caregivers, resulting in 2002-03 savings of \$42 million (\$21 million General Fund). The regulations to implement these wage increases have not been finalized.

Department of Health Services (DHS)—Public Health

- ◆ **Cancer Research**—Eliminating State-funded cancer research, as existing research contracts expire, to capture savings of \$12.5 million in 2003-04 and annually thereafter.
- ◆ **Prostate Cancer**—Reducing the Prostate Cancer Treatment Program by another \$5 million for a total reduction of \$15 million in the budget year, leaving \$5 million to support the lower-than-anticipated participation in the program.

Department of Developmental Services—Redefining the State's definition of "substantial disability," which is used to determine whether individuals are eligible for service, resulting in \$2.1 million General Fund savings. The redefinition, which would be applied prospectively, will more closely align the State and federal definition, requiring limitations in three of the seven major life activity domains in order to establish eligibility.

Department of Mental Health—Eliminating the Early Mental Health Services program, to achieve \$15 million General Fund savings and protect other vital programs from reduction or elimination. This program provides services to children experiencing school failure and is counted toward the Proposition 98 guarantee.

Department of Social Services

- ◆ **SSI/SSP and CalWORKs Grants**—Reducing the Supplemental Security Income/State Supplementary Payment (SSI/SSP) grant to the federally required maintenance-of-effort level, effective July 1, 2003, for General Fund savings of \$662.4 million in 2003-04. The Budget also proposes to reduce CalWORKs grant levels by approximately 6 percent from the level in the 2002 Budget Act in order to achieve a grant reduction consistent with the reduction for SSI/SSP recipients.
- ◆ **Licensing Review**—Streamlining the annual review of licensed care facilities to allow resources to be focused on facilities in which health and safety may be at greatest risk, for savings of \$7.6 million (\$5.8 million General Fund) and the elimination of 62 positions. In addition, the Budget proposes to increase fees for licensed facilities, resulting in increased General Fund revenues of \$6.8 million.



Proposition 98 Programs

- ◆ **Selected Proposition 98 Categorical Programs and Block Grant**—Additional savings of \$542 million by reducing certain K-14 categorical programs by 7.46 percent in 2002-03. These reductions and the \$1.078 billion in across-the-board reductions in the Mid-Year Spending Reduction Proposals plan are proposed to be continued into 2003-04. Some K-12 categorical programs are proposed to be further reduced in 2003-04 by 1.28 percent for \$71 million in savings. K-12 funding deferred from 2002-03 to 2003-04 is also proposed to be reduced by 3.66 percent, as was proposed in December 2002 for other 2002-03 appropriations, to produce \$51.4 million in savings. Over the two years, these reductions total \$2.284 billion.

To provide significant additional flexibility to districts to manage within these reduced funding levels, the Budget proposes to consolidate 64 programs into a \$5.1 billion block grant for the purposes of professional development, instructional materials and technology, specialized and targeted instructional programs, school safety, and student services.

- ◆ **Normal Proposition 98 Funding Growth**—Suspending statutory growth for categorical programs and cost-of-living adjustments for all programs, to achieve total savings of \$992 million. This includes \$106 million in enrollment-driven adjustments to categorical programs, consistent with the decision to reduce these programs, and \$886 million by not funding cost-of-living adjustments at the initial 1.96 percent estimated statutory rate for Proposition 98 programs, including apportionments.
- ◆ **Additional Specific Proposition 98 Reductions and Savings**—Continuing proposed savings from the Mid-Year Spending Reduction Proposals plan, suspending or eliminating programs, making targeted reductions of lower priority activities, and reflecting audit recoveries, for savings of \$51 million in 2002-03 and \$808 million in 2003-04. This includes \$212 million in reductions to Community Colleges categorical programs.

Higher Education

- ◆ **Partnership Agreement**—Suspending increases related to the Partnership Agreement, including the 4 percent general operating budget increase, 1 percent for core needs, funds for buy-out of fee increases, and continuing one-time reductions included in the current-year Budget related to core needs, to generate \$438 million in savings from the University of California (UC), California State University (CSU), and Hastings College of Law. The Budget fully funds enrollment growth.



- ◆ **Base Reductions**—Reducing the base General Fund budgets for UC, CSU, and Hastings by an additional \$317 million for 2003-04. These reductions are anticipated to be offset through additional fee increases by actions of their governing boards.
- ◆ **Additional Targeted Reductions**—Eliminating funding for UC's Subject Matter Projects, increasing the student to faculty ratio for the CSU, and other reductions, to achieve savings of \$72 million in 2003-04.
- ◆ **Financial Aid Programs**—Eliminating the Student Aid Commission's Work Study program, reducing the number of Cal Grant T and C awards, reducing by 9 percent the amount of the Cal Grant awards for students attending private institutions, and additional state operations reductions to the Commission, to achieve \$23 million in savings.

Local Government

- ◆ **Vehicle License Fee Backfill**—Reducing the vehicle license fee backfill to cities and counties pursuant to the reduction in vehicle license fees for car owners, for a General Fund savings of \$1.265 billion in 2002-03 and \$2.929 billion in 2003-04.
- ◆ **School District Redevelopment Increment**—Requiring that the school district share of property tax revenue resulting from growth in assessed value in redevelopment project areas, which is currently retained by Community Redevelopment Agencies, be passed through to schools beginning at the level of \$250 million in 2003-04, and increasing to the full amount of diverted property taxes over time.

State-Local Realignment—\$8.0 billion

The 2003-04 Governor's Budget reflects General Fund savings of \$8.154 billion due to the realignment of existing programs in various areas (including \$191.6 million reflected in the Mid-Year Spending Reduction Proposals plan). These proposals will result in estimated costs to counties/trial courts of \$8.273 billion. Under realignment, counties and trial courts will be provided with an ongoing dedicated revenue stream to support these programs. Realignment will provide counties and trial courts greater flexibility in the use of these funds and administration of the programs, as well as improved fiscal incentives for cost-effective service delivery. The components of the realignment proposal are as follows:

- ◆ Mental Health and Substance Abuse—\$306 million
- ◆ Children and Youth—\$2.307 billion
- ◆ Healthy Communities—\$2.671 billion



- ◆ Long-Term Care—\$2.571 billion
- ◆ Court Security—\$300 million

See the Preserving Critical Programs section for additional details of the proposals.

Fund Shifts—\$1.1 billion

The Governor's Budget includes a shift of funding source for various programs or projects, thereby making General Fund resources available for other critical needs. Highlights of these fund shifts include:

- ◆ **Trial Court Funding**—Implementing various fee increases to support the operation of the trial courts. The revenue from these fees will be deposited in the Trial Court Trust Fund and will partially offset the General Fund support currently provided to the trial courts.
 - ◇ A new court security fee of \$20 per court filing will result in revenue of \$34 million annually.
 - ◇ An increase in the trial motion fee from \$23 to \$33 will result in revenue of \$1.2 million annually.
 - ◇ A transfer of revenue from various undesignated fees on court-related activities from the counties to the courts, totaling \$31 million annually.
- ◆ **Department of Pesticide Regulation**—Implementing the “polluter pays” principle by increasing the mill assessment by \$7.5 million, and shifting all support of the department to non-General Fund sources.
- ◆ **Air Resources Board**—Implementing the “polluter pays” principle by shifting \$10 million in General Fund support for the stationary source pollution control program to increased Air Pollution Control Fund fee revenues.
- ◆ **State Water Resources Control Board**—Implementing the “polluter pays” principle for the Board's core regulatory programs by replacing \$13.6 million General Fund with increased fee revenues in the Waste Discharge Permit Fund. This will increase the regulated community's support of the core regulatory program from approximately 50 percent to 100 percent.
- ◆ **Healthy Families Program**—Due to the structure of the Tobacco Settlement Fund (TSF) securitization, up to \$220 million in one-time TSF is available in 2003-04 to maintain the current Healthy Families Program caseload, in lieu of \$220 million in General Fund resources.



- ◆ **Transfer of Federal Title XX Grant Funding to Regional Centers—**A \$65.7 million General Fund savings is achieved as a result of a fund shift for regional centers. As a result of decreased CalWORKs grants, there are savings in Temporary Assistance to Needy Families funds that can be transferred to Title XX. The commensurate Title XX savings can then be used in lieu of General Fund.
- ◆ **Proposition 98 Programs**
 - ◇ **Proposition 98 Shifts to Reversion Account—**In addition to the amounts proposed in December 2002, \$132 million in 2002-03 Proposition 98 General Fund appropriations are replaced with funding from the Proposition 98 Reversion Account, which contains balances of savings that have been identified in prior year appropriations.
 - ◇ **Shift to Federal Funds—**\$81 million in Proposition 98 General Fund savings is achieved by using federal funds for 2002-03 Stage 3 Child Care and High School Exit Exam workbooks.
 - ◇ **Use of Excess Local Property Taxes to Fund Proposition 98 Programs—**\$136 million in Proposition 98 General Fund costs are shifted to property taxes allocated to basic aid districts that are above the amount needed to fund their revenue limits.
 - ◇ **Community College Fees—**\$365 million in Proposition 98 savings is estimated from increasing Community College fees from \$11 per unit to \$24 per unit.

Transfers and Other Revenues—\$1.9 billion

Indian Gaming Revenue—In 1999, the Governor entered into Tribal-State Gaming Compacts with 61 federally recognized Indian tribes. These compacts can be opened for renegotiation in 2003. There are also a number of federally recognized tribes that do not currently have compacts that have indicated an interest in negotiating compacts with the Governor.

It is anticipated that negotiations with the existing compact tribes, as well as tribes seeking compacts, will result in revenue sharing agreements, and a new source of revenue for the General Fund. The Budget assumes these revenue sharing agreements will generate \$1.5 billion in additional revenue to the General Fund.



Department of Child Support Services—The Budget reflects General Fund savings of \$51.8 million due to the proposal to implement a 25 percent county share-of-cost for the federal penalty levied on California because a single, statewide automated child support system was not implemented by the federal deadline. This sharing ratio is consistent with that required for other social services programs.

Department of Developmental Services—General Fund revenues of \$31.6 million will be realized by requiring parents to share in the cost of providing services to their children. The co-payment would apply to parents with minors living at home who receive services from regional centers. The amount of the co-payment would be assessed on a sliding scale based on income and applied only to families earning more than 200 percent of the federal poverty level.

Transfers of Excess Fund Balances from Specific Funds—The Budget proposes the transfer of idle cash balances to the General Fund from various other funds, where the balances are not legally restricted. The transfers from these funds are reflected in the fund conditions in individual departmental budget displays. These proposed transfers total \$107 million. The major funds and transfer amounts are as follows:

Fund (Millions)	Amount
Wildlife Restoration Fund	\$25.0
State School Building Aid Fund	24.3
Driver Training Penalty Assessment Fund	20.5
Peace Officer Training Fund	14.3
Corrections Training Fund	10.2
Renewable Resource Trust Fund	6.3

Additionally, \$6 million of funds are proposed for transfer from various other funds.

Loans and Borrowing—\$1.7 billion

State Contributions to the California Public Employees' Retirement System (CalPERS) and the State Teachers' Retirement System (STRS)—The Administration proposes to take advantage of currently favorable interest rates by pursuing legislation to authorize pension obligation bonds to fund the State's budget year retirement obligations to both CalPERS and STRS. The Administration will simultaneously be entering into discussions with the CalPERS and STRS boards to explore the possibility of a loan, as a part of each system's fixed-income investment portfolio.



lio, to pay the 2003-04 State employer contributions. Whichever approach is ultimately adopted, this proposal will result in reduced General Fund expenditures of approximately \$1.5 billion in 2003-04.

Loans from Various Special Funds—The Budget proposes additional loans totaling \$148 million from various special funds to the General Fund. These loans will be repaid with interest at the rate earned by the Pooled Money Investment Account.

The Budget includes a provision that requires all loans to be paid back to the lending fund when needed to meet budgeted expenditures. The funds and loan amounts are as follows:

Fund (Millions)	Amount
Beverage Container Recycling Fund	\$80.0
California Tire Recycling Management Fund	15.0
Agricultural Fund	15.0
Contractors' License Fund	5.0
State Dentistry Fund	5.0
Vehicle Inspection and Repair Fund	5.0
Private Security Services Fund	4.0
Underground Storage Tank Cleanup Fund	3.2
California Debt and Investment Advisory Fund	3.0
Tax Credit Allocation Fee Account	3.0
Integrated Waste Management Account	2.0
Targeted Inspection Fund	2.0
Other	6.0

